

Letter of Findings Number: 04-20100618 and 04-20110083
Sales/Use Tax
For Tax Years 2007 and 2008

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ISSUES

I. Sales/Use Tax--Audit Methodology.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-4-13; Sales Tax Information Bulletin 51T (July 2004), 27 Ind. Reg. 3390; IC § 6-8.1-5-1(c); IC § 6-8.1-5-4; IC § 6-8.1-5-1(b).

Taxpayer protests the projection methodology used regarding sales tax for prepaid phone cards.

II. Tax Administration--Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#); IC § 6-2.5-4-6; IC § 6-2.5-4-13; Sales Tax Information Bulletin 51T (July 2004).

Taxpayer protests the imposition of ten percent negligence penalties that resulted from the audit of two its stores.

STATEMENT OF FACTS

Taxpayer operates grocery stores. Two of Taxpayer's stores were audited (for purposes of clarity, Docket Number 04-20100618 will hereinafter be referred to as "Store A," and Docket Number 04-20110083 will be referred to as "Store B"). The Audit Reports for both "Store A" and "Store B" state that, "A review of the taxpayer's sales tax records for 2007 and 2008 revealed that the taxpayer was not charging customers sales tax on the sale of prepaid phone cards." Taxpayer protested the "projection methodology" of its sales/use tax audit for "Store A." Taxpayer also protests the imposition of a ten percent penalty that resulted from the audit of "Store A." Regarding the audit of "Store B" Taxpayer only protests the imposition of a ten percent negligence penalty. A hearing was held and this Letter of Findings ("LOF") results. More facts will be provided below as needed.

I. Sales/Use Tax--Audit Methodology.

DISCUSSION

Taxpayer states that it "operates specialty grocery stores," which sell "a variety of items including prepaid phone cards." As noted above, Taxpayer's protest of the Audit Methodology was for "Store A," thus this section of the LOF only addresses "Store A." In its protest letter Taxpayer states regarding "Store A":

The Indiana Department of Revenue field auditor has assessed Taxpayer for failure to collect sales tax on sales of prepaid phone cards. Taxpayer agrees that phone cards are taxable and that Taxpayer did not collect the sales tax as required by the department's Information Bulletin #51T, Sales Tax. Taxpayer disagrees with the auditor's approach to calculating the tax due.

Taxpayer further states that the information for the audit was taken "from Taxpayer's POS system that purports to be the account where all phone cards were sold through the POS system. Based on his calculations, the auditor has calculated that total phone card sales were 21[percent] of the total sales at the store location." Taxpayer takes issue with this 21 percent amount.

As a preliminary matter, the Department notes that Indiana imposes a sales tax on retail transactions and a complementary use tax on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-2-1; IC § 6-2.5-3-2. Also of importance is IC § 6-2.5-4-13, which states:

A person is a retail merchant making a retail transaction when a person sells:

- (1) a prepaid telephone calling card at retail;
- (2) a prepaid telephone authorization number at retail;
- (3) the reauthorization of a prepaid telephone calling card; or
- (4) the reauthorization of a prepaid telephone authorization number.

And Sales Tax Information Bulletin 51T (July 2004), 27 Ind. Reg. 3390, states in relevant part that a "person is a retail merchant making a retail transaction when the person sells a prepaid telephone calling card at retail...."

Turning to the issue at hand, the Department notes that regarding books and records, IC § 6-8.1-5-4 states:

(a) Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks.

(b) A person must retain the books and records described in subsection (a), and any state or federal tax return that the person has filed:

- (1) for an unlimited period, if the person fails to file a return or receives notice from the department that the

person has filed a suspected fraudulent return, or an unsigned or substantially blank return; or
 (2) in all other cases, for a period of at least three (3) years after the date the final payment of the particular tax liability was due, unless after an audit, the department consents to earlier destruction.

In addition, if the limitation on assessments provided in section 2 of this chapter is extended beyond three (3) years for a particular tax liability, the person must retain the books and records until the assessment period is over.

(c) A person must allow inspection of the books and records and returns by the department or its authorized agents at all reasonable times.

(d) A person must, on request by the department, furnish a copy of any federal returns that he has filed.

And IC § 6-8.1-5-1(b) states:

If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department. The amount of the assessment is considered a tax payment not made by the due date and is subject to [IC 6-8.1-10](#) concerning the imposition of penalties and interest. The department shall send the person a notice of the proposed assessment through the United States mail.

Regarding the audit's methodology, the Audit Report states:

The examiner was able to determine the amount of phone card sales through taxpayer's point of sale (POS) system. Sales tax was not charged on any sales that were included into the phone card sales account. Therefore, the entire amount of the sales in this account should have been subject to sales tax. Since the POS system was not introduced until 12/01/2007, the numbers from the POS system were only used to determine prepaid phone card sales for 12/01/2007-12/31/2008.

(Emphasis added).

The Auditor further states that: "Register tape was available for the remainder of the audit period (1/1/2007-11/30/2007)." Given the volume of records, the Auditor projected from the phone cards sales from the POS system. The Auditor states: "From the sample data, the examiner calculated the percentage of total sales that were from phone card sales. This percentage was applied to the reported sales claimed on the ST-103 for 1/1/2007-11/30/2007 to determine the projected amount of the phone card sales for the projection period."

Taxpayer argues its "POS system is inherently unreliable as it was implemented during the audit period and depends solely on manual input from clerks who could have misunderstood how to use the system" Taxpayer states that it has "accurate information regarding the purchases of phone cards and the average mark up used for phone card profits." Taxpayer's alternative methodology was sent in a letter to the Auditor, thus the Auditor was aware of it. That letter states in relevant part:

[W]e do have substantial support for the sales tax calculation at the [] location other than for the time period of January – June 23, 2007 due to a fire at this location. (All records prior to June 24th, 2007, were lost in the fire, including all computer records). We are enclosing copies of invoices showing the actual phone card purchases during this time to support our calculation.

The method Taxpayer proposes is to use "actual purchases... for the periods June 24-December 31, 2007 and all of 2008." Taxpayer goes on to state, "Due to the fire in 2007, we have doubled the purchases from the period of June 24-December 31, 2007 to calculate estimated total purchases for 2007." Further, Taxpayer states that it has "purchase records for all of 2008" and that "[f]rom the 2007-2008 purchases" that Taxpayer "calculated an average mark up price...." Taxpayer's basis for this "average markup price of all phone card sales" is from one supplier, which Taxpayer claims "should be a good representation of all the companies that [Taxpayer] buy[s] from."

The Department notes that under IC § 6-8.1-5-1(c), "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." As noted supra, due to a fire, some of the records are missing. Taxpayer argues that its own records (i.e., POS system) are "inherently unreliable," and thus the Audit is incorrect since it is based on Taxpayer's POS system records. As an alternative to its own POS system being used for the projection, Taxpayer proposes a methodology that involves such things as an average markup price on phone cards based on only one supplier. Taxpayer has not demonstrated that its proposed methodology is based on better information than the audit's methodology. Taxpayer has not met its burden of proof under IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is denied.

II. Tax Administration–Negligence Penalty.

DISCUSSION

Taxpayer protests the imposition of the negligence penalties (IC § 6-8.1-10-2.1) for both "Store A" and "Store B." The Department refers to [45 IAC 15-11-2\(b\)](#), which states:

"Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated

as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

(Emphasis added).

And [45 IAC 15-11-2](#)(c) provides in pertinent part:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer argues "that the deficiency was due to reasonable cause and not willful neglect." Taxpayer states that:

Taxpayer believes that their failure to collect tax on pre paid phone cards resulted from the confusion regarding the taxability of interstate phone calls. [IC 6-2.5-4-6](#) only imposes sales tax on intrastate phone calls. Taxpayer believed that their customers were purchasing prepaid phone cards to make interstate calls. Taxpayer was unaware of Information Bulletin #51 T.

However, IC § 6-2.5-4-6 is not applicable to the Taxpayer's facts—Taxpayer is not furnishing or selling telecommunication services. Taxpayer is a retail merchant that sold prepaid phone cards. The relevant statute for that is IC § 6-2.5-4-13, which states:

A person is a retail merchant making a retail transaction when a person sells:

- (1) a prepaid telephone calling card at retail;
- (2) a prepaid telephone authorization number at retail;
- (3) the reauthorization of a prepaid telephone calling card; or
- (4) the reauthorization of a prepaid telephone authorization number.

(Emphasis added).

As noted, Taxpayer admits that it was "unaware of Information Bulletin #51 T." [45 IAC 15-11-2](#)(b) states that "Ignorance of the listed tax laws, rules and/or regulations is treated as negligence." The Department finds that Taxpayer has failed to establish reasonable cause under [45 IAC 15-11-2](#)(c).

FINDING

Taxpayer's protests are denied.

SUMMARY

In summary, Taxpayer's protest of the audit's projection methodology for "Store A" is denied. Taxpayer's protests of the penalties for "Store A" and "Store B" are also denied.

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